U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT



OFFICE OF MULTIFAMILY HOUSING ASSISTANCE RESTRUCTURING

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MEMORANDUM FOR: All OMHAR Staff and Participating
Administrative Entities

FROM: S. Paige Warren, Deputy Director for Production, OMHAR

SUBJECT: Rental Assistance Assessment Plans (RAAPs) and Tenant Based Assistance in Mark-to-Market Transactions

Successful Mark-to-Market (M2M) debt restructurings can result in either tenant-based, or project-based Section 8 assistance, except for properties that are "safe harbored". Safe harbored properties are those in a tight rental market, predominantly occupied by elderly or disabled families, and cooperatives. For all other properties in M2M, PAEs need to determine the form of rental assistance to be provided after the debt restructuring. MAHRA requires this decision be made and documented through a Rental Assistance Assessment Plan (RAAP).

To date, all debt restructurings have lead to a determination of project-based assistance, notwithstanding our expectation that some number would convert to tenant-based assistance. PAEs and OMHAR staff are reminded that MAHRA requires that

- Each property to be evaluated individually (except for safe harbored properties) based on eight criteria, and
- PAEs to report to OMHAR on (1) any properties with Restructuring Plans which result in tenant-based assistance, and (2) any properties in which the tenants of the project generally supported a conversion to tenant-based assistance, but was renewed with project-based assistance instead. This reporting requirement applies regardless of whether the property is safe-harbored.

Positive factors that might result in a tenant-based conclusion / restructure include the potential benefit of encouraging a mixed-income tenant profile, potential for enhancing the real estate (and the neighborhood) through turnover more representative of market dynamics, encouraging operating efficiencies, and giving the tenants a choice in where they live.

Positive factors that occur with project-based restructures include preservation of affordable housing in a housing market with few options, cheaper HUD administration costs, a greater sense of stability for existing tenants, and generally a more predictable income stream for the owner with a typically lower overall vacancy percentage.

OMHAR's position is neutral as to what is the best type of assistance for each individual property. However a weak analysis may call into the question the decision reached. OMHAR has recently reviewed numerous RAAPs and as a result has decided to issue additional guidance to assist PAEs.

A RAAP is not required if a property is safe harbored. However, the analysis required to complete the RAAP questions is still necessary in many safe harbored cases. Determination of the appropriateness of exception rents, and / or determining whether the expected loss to HUD is acceptable (preservation worthy) relies in great part on answers to the same questions.

Even though exception rents and tenant-based assistance are mutually exclusive, a RAAP is still required (unless the property is safe harbored.)

The Regulations, 401.421(c), allow for up to a five-year phase-in for tenant-based assistance. The justification for a phased conversion would be the need for financial viability during the transition period. This option is particularly important, but not limited to, out-year restructurings when a conversion could be completed at expiration of the current contract.

A RAAP should address each of the eight factors noted in the Regulations and discussed in Attachment 1. In addition, the RAAP should incorporate a section on stakeholder views. This section would not only cover the view of the tenants and owner, but also the local multifamily office, community groups and local government officials.

The RAAP should be finalized by a reasoned conclusion supported by the analysis. The document should be consistent - internally and with the rest of the Restructuring Plan. Inevitable contradictory data and observations in the individual factors must be explained, weighed and resolved in the conclusion.

Attached is an updated discussion of each of the eight factors addressing some of the weaknesses we have seen in RAAPs completed to date. Also attached is an Overview of Tenant-Based Assistance, including a case study addressing commonly asked questions about tenant-based assistance.

Please contact Norm Dailey (202-708-0001) if you have any

questions about this memorandum.

Attachments

Attachment 1 EIGHT RAAP ANALYSIS FACTORS

1. <u>Tenants' ability to find adequate, available, decent, comparable, and affordable housing in the local market.</u>

Many times the question is answered under the assumption that immediately upon closing all tenants will have to find alternative housing. A good restructure may in fact result in most tenants staying at the building using their vouchers. A good RAAP is forward looking, not just current conditions. If, for whatever reason, a tenant wanted to relocate in the future, including deteriorating property condition, would the tenant be able to obtain comparable or better housing using the voucher?

A critical discussion point under this factor is vacancy rate and the PHA Voucher utilization rate, including trends. Even if the market-wide vacancy rate is 6.0% or higher, the vacancy rate in the affordable housing sub-market may be below 6.0% or vice-versa. In addition, just the vacancy rate may not address whether alternative housing is decent and/or comparable.

A general guideline (to be used as a starting point, not as a substitute for analysis) is that tenant-based Section 8 assistance should provide project residents with adequate affordable housing choices if at least 30% of the standard quality rental units in the relevant local housing sub-market have rents less than the applicable FMR. This guideline adds a neighborhood or sub-market dimension to assessing the ability of residents to make housing choices using tenant-based assistance.

If there are no other rental housing options and tenants really don't have a choice of alternative housing in the relevant market, then project-based assistance is the preferred option under this criterion.

2. The types of tenants residing in the project.

This criterion relates to whether the tenants would be willing or able to move to better housing if they had a choice, either immediately or in the future.

A project may not meet the definition of elderly and disabled housing but because it has a large minority of elderly and disabled residents it may be advisable to maintain its project-based status. The statutory safe harbor provision presumes that elderly and disabled residents have a significantly higher desire not to relocate. Generally this is true, but except for safe harbored properties, this assumption should not be taken for granted.

Under either question Number 1 or 2, issues relating to whether the property may serve large families or families with

children in an area where there may be a shortage of that particular type of rental unit could be covered (i.e. 3 bedroom and larger units). Parking or access to public transportation could also be covered under either question.

3. Local housing needs identified in the Community Development Block Grant Consolidated Plan and local market vacancy trends.

Any relevant excerpts from the Consolidated Plan should be attached to the RAAP. The Plan will indicate whether the community is experiencing a shortage of affordable housing alternatives. The answer to this factor should support your answer under Factor 1. In addition, the word "trends" is important. Is new affordable housing being built? Is the area losing population so that the pool of affordable housing is increasing, and increasing in quality?

The PAE's analysis should opine on the relevance of the Consolidated Plan to the specific property situation; sometimes the local policies and preferences in the Consolidated Plan will be particularly relevant, but in other cases the Consolidated Plan will have focused on issues that are not directly relevant to the subject property.

4. The cost of providing assistance.

Appendix M of the OPG states that PAEs should "Compare the Section 8 cost per unit assisted using the tenant-based payment standard to the Section 8 cost per unit assisted using project-based Section 8." If the payment standard is higher than the PAE determined market rents, tenants may be tempted to move to better units, assuming market forces are at work, i.e. higher rents mean better units. If the payment standard is lower, over time the cost might be less under a tenantbased scenario. As tenants moved from the property, new voucher tenants would only receive up to the payment standard as a subsidy (See Case Study, Attachment 2.). However, immediately after conversion the costs might be equal, e.g. if the subject property is better than properties on the market accepting vouchers. Note that administrative costs are higher for tenant-based assistance (7% vs 3%).

5. The project's long-term financial stability.

Consider what impact the future loss of rental assistance caused by existing residents moving from the property would have on the owner's ability to generate enough cash flow to adequately maintain the property and support the property's overall debt obligation. Refer to, and discuss, the analysis in the underwriting/modeling, and the differences in project-based and tenant-based expenses and vacancy percentages.

If the PAE is concerned about the property's ability to survive an immediate conversion to vouchers, MAHRA provides for phasing the conversion over a transition period of up to 5 years.

6. Residents' ability to make reasonable choices about their individual living situations.

Evaluate the resident's participation in the tenant meetings. Were the tenants knowledgeable about other housing choices and were they involved in the M2M process? Were their expectations reasonable? Also, do the tenants have access to outside resources to assist them in making decisions such as local community organizations?

7. Neighborhood quality.

If the project is the most well maintained property in the neighborhood (and operating expenses are historically reasonable), it might be best for the property to continue to be project based. Otherwise the owner may not have any incentive to maintain the above average condition. Conversely, if other properties are better, market and competitive forces (tenant based forces) should assist in maintaining a property that will be improved through the M2M restructure. If the neighborhood is undesirable, a tenant-based approach is likely to provide greater choice for residents. Consider the impact of the housing stock in areas with low poverty rates (e.g., less than 20%) and where the project promotes housing opportunities for minorities.

8. The project's ability to compete in the marketplace.

Consider how the inability to provide project-based rental assistance to tenants might impact the owner's ability to market the property to tenants in the future.

OMHAR expects that Restructuring Plans will position the property to compete in the marketplace, whether or not project-based assistance is renewed. Therefore, this criterion is not concerned with whether the property can compete, but rather whether the property would be better able to compete under project-based or tenant-based assistance

Attachment 2

Overview of Tenant-Based Assistance

Local Public Housing Agencies (PHAs) administer tenant-based assistance under the oversight of HUD's Office of Public and Indian Housing (PIH). The PHAs qualify the tenants, inspect the units, and make payments to landlords under the terms of their Annual Contributions Contract (ACC) with HUD.

For properties in M2M (and certain other situations), income and otherwise eligible tenants who were previously assisted by project-based assistance are provided Enhanced Vouchers, sometimes referred to as "sticky vouchers". Rents using these vouchers are set at market. These vouchers allow tenants to either stay in the property or to move with continued rental assistance. If the tenant chooses to move, the maximum subsidy that may be paid under the voucher program is determined by the payment standard set by the PHA (typically between 90% and 110% of FMR). Families that choose units where the gross rent exceeds the payment standard pay the difference out-of-pocket in addition to total tenant payment. If the family chooses to remain at the M2M property, however, the normal payment standard limitation does not apply. voucher subsidy is "enhanced" to cover the difference (if any), between the gross rent and the payment standard, provided that the rent to owner is reasonable when compared to similar unassisted units in the market.

Each "voucher holder" signs a lease with the landlord, and the PHA will enter into a separate Voucher Housing Assistance Payments Contract with the landlord on behalf of each individual tenant. If 100 voucher holders live in a 100 unit building, there are 100 contracts, as opposed to project-based assistance where there is one contract. The PHA pays the landlord directly, and most typically (but not always) would aggregate all voucher payments and send one check. Before a voucher holder can enter a lease, the PHA must inspect the unit and make a determination of rent reasonableness (essentially a determination of market rent.) Annually, the PHA inspects 100% of the units (rather than a sampling, as in the case of project-based assistance) and recertifies each family's income.

Normally the calculation for payments to the landlord is:

 For properties with gross rents (rent to owner plus the PHA utility allowance for any tenant-supplied utilities) above the payment standard:

Payment standard minus total tenant payment (generally 30% of tenant's monthly adjusted income).

For properties renting below the payment standard,

Gross Rent minus total tenant payment (generally 30% of

the tenant's monthly adjusted income).

• For Enhanced Vouchers, the calculation is:

Gross rent (Based on market) minus the tenant payment (generally 30% of the tenant's monthly adjusted income)

As long as the original tenant stays in the original unit, they will receive an enhanced voucher.

Attachment 2

Case Study

The following is a fictional case study showing how the program works:

Mary, a single woman, 30 years old, lives and works in Central PA., makes \$15,000 per year (\$1,250/mo, she had no deductions so 30% of monthly adjusted income is \$375 and is her total tenant payment). OMHAR Market Rent at Shady Acres is \$500/mo (Current Project-Based rents are \$800)

- What is the Amount of the Enhanced Voucher if the PHA Payment Standard is revised upward or downward, but OMHAR's market rent remains at \$500:
 - 1. PHA Payment Standard \$525
 - 2. PHA Payment Standard \$475
 - 3. PHA Payment Standard \$500

In all of the above cases, Mary receives an Enhanced Voucher for \$500. She pays \$375 and the landlord receives \$125 from the PHA.

 Mary wants to move in 12 months to New York City, no change in salary (New York Payment Standard \$1,000). Mary's property in Central PA was restructured with tenant-based assistance.

The <u>Central, PA PHA</u> pays to the New York landlord via the NY PHA \$625 (\$1,000-\$375). New York PHA would complete the inspection and ensure the rent charged was reasonable. The New York PHA might issue the voucher themselves, if they have a voucher utilization problem and want to boost their usage percentage (use it or lose it).

• What if Shady Acres stayed as project-based

Mary would have to find a project-based unit in New York or apply for a voucher from the New York PHA and in New York would be placed on a waiting list (if New York is even accepting new applications).

 Mary wants to move across town into a nicer place, market rent \$500, which equals the PHA Payment standard.

The PHA would inspect the unit under Housing Quality Standards (HQS) and ensure rent is reasonable and pay the landlord \$125. This is no longer an enhanced voucher.

• What happens if the place across town is a project-based unit?

Mary relinquishes her voucher if she wants to move into project-based unit.

 What if Mary wants to move into a nicer place, market rent \$475

New landlord receives payment of \$100; this is no longer an enhanced voucher.

 What if Mary wants to move into a much nicer place, with pool, with a market rent of \$650 per month

Normally, the PHA, assuming the apartment meets HQS and rents are deemed reasonable, the PHA would pay \$125 (No longer an enhanced voucher), which is \$500 payment standard minus Mary's TTP (in her case 30% of monthly adjusted income or \$375). Mary is also responsible for paying an additional \$150 (\$650-\$500) to cover the amount by which the gross rent exceeds the payment standard. However, in this particular case another rule comes into play, in that Mary cannot pay more than 40% of her monthly-adjusted income for rent when she initially leases a unit. Since 40% of her monthly-adjusted income equals \$500, she can't rent this unit using a voucher because her share of the gross rent would be \$525.

• If an enhanced voucher family moves from the project, what happens to the original unit?

The original unit then becomes a market rent unit. If the property went through a Mark to Market restructure, rents for the rent-restricted units (either 20% or 40% of the units) may not exceed the maximum rents provided under the Use Agreement. The rents for units occupied by families that are provided enhanced vouchers must be determined by the PHA to be reasonable in comparison to similar unassisted units in the market. The Use Agreement also requires no discrimination in renting to tenants with vouchers. rents for units rented to regular voucher holders who subsequently move to the property must also be reasonable. Any family moving into the property with tenant-based assistance (including Mary if she chooses to return) do not receive enhanced voucher assistance. If the owners' gross rent exceeds the PHA payment standard, the family must pay the difference out of pocket.

HUD does not regulate the rents for the remaining, non-rent-restricted units. However, the owner may not charge unassisted families lower rents than the voucher holding families.

 After the initial lease term of the enhanced voucher families, the owner feels that the OMHAR determined market rent is now too low, by \$50 (Assume payment standard stayed at \$500).

The PHA would come out and determine if the higher rent was reasonable. If so, the enhanced voucher subsidy would be based on the new gross rent for the unit. If the PHA

determined that the additional \$50 was not reasonable and the landlord was firm, the families would have to move to continue to receive voucher assistance. The owner would still be subject to the Use Agreement and have rent restricted units.

 Mary gets promoted to manager, salary goes to \$50,000 (What if stayed Project Based)

Mary would keep the voucher for 6 months, but no payments would be made to the landlord. If the property stayed as Project Based, Mary would have to move.

• Mary continues to live in the unit for the next 30 years

As long as the rents were considered reasonable and the property meets HQS, Mary and the landlord would receive the benefit of the enhanced voucher. (Assuming Congress doesn't change the rules and provides sufficient appropriations)